USDA Foreign Agricultural Service
GAIN Report
Global Agricultural Information Network

Required Report - public distribution

Date: 5/15/2014
GAIN Report Number: NZ1406

New Zealand

Dairy and Products Semi-annual

2014 New Zealand Milk and Dairy Products Semi-Annual Report

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Report Highlights:

New Zealand Dairy Farms have recovered from the 2013 drought even better than had been expected. The milk supply forecast for MY2014 is revised upward to 21.35 million metric tons. Very high prices for Whole Milk Powder late in 2013 going into 2014 has continued the drive upward in WMP production and exports. In MY2014 forecast WMP production has been revised up to 1.37 million MT and exports to 1.34 million MT.

Executive Summary

"Onward and upward" would appear to be the catchphrase for New Zealand dairy farmers at the moment. Even though drought (centered in the Waikato, North Island region) once again threatened on-farm production covering over 40% of the total dairying area, nationally milk supply for 2014 is set to increase six percent year on year to reach 21.35 million metric tons (MT). This is a four percent upward revision of the previous forecast and is due to a 16% boost in overall milk supplies in the first half of 2014 compared with the same period in 2013. A record forecast milk price has prompted North Island farmers to feed increased levels of supplements to maintain production. This combined with significant increased production from the South Island is behind the boost.

Whole milk powder (WMP) again has been more profitable than the other products and is likely to tip the production scales at 1.37 million MT in 2014. This represents a five percent upward revision based on increased processing capacity as well as a forecast upward trend in production of 60-65 TMT. There is nothing at present to suggest this trend won't continue. Exports are now forecast at 1.34 million MT, which represents a slight 5,000 MT increase from previous forecasts. The production increase in excess of the extra export requirement is forecast to be used for revised domestic consumption and to rebuild stocks. WMP production in 2013 has been revised upward by 2% to 1.3 million MT. The increased production fueled higher exports and increased domestic consumption.

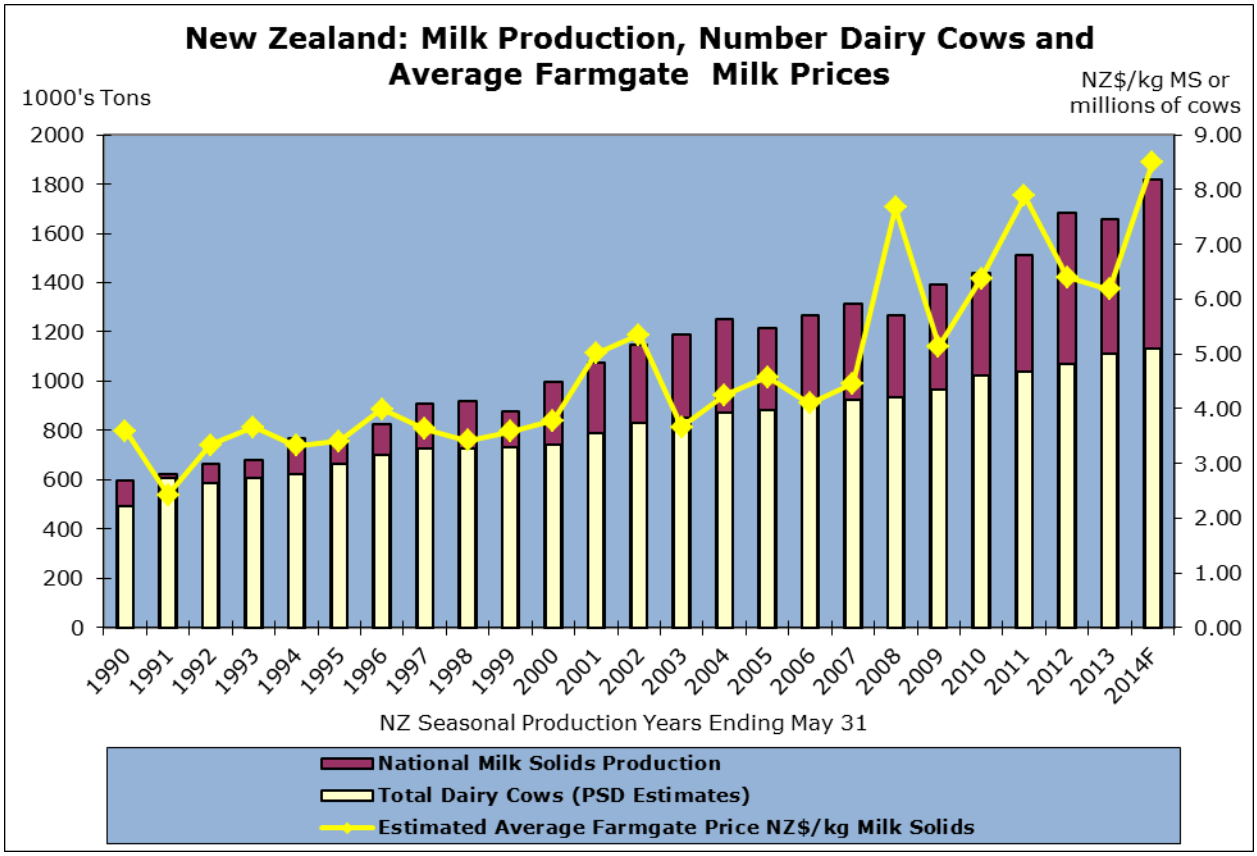
Another profitable commodity grouping for New Zealand dairy producers is skim milk powder (SMP) and butter or anhydrous milkfat (AMF) powder group. This combination in terms of profitability is second only to WMP. It is forecast in 2014 that production of SMP will be 425,000Mt and butter/AMF in butter equivalents 540,000MT, both revised upward by one percent and three percent respectively. Exports of these two categories are forecast to increase along with the production increases to 425,000MT in 2014 for SMP and 516,000MT for butter/AMF. This amounts to revisions of 5% and 3% for SMP and butter/AMF respectively.

Cheese production is assumed to be stable within a range of 300,000MT to 320,000MT per annum. Production is expected to reach 320,000MT in 2014 after recovering from the drought reduced estimated total production in 2013 of 306,000MT. The nature of New Zealand cheese production and exports is changing. Ten years ago production consisted of predominantly natural ingredient cheese, such as Cheddar and Gouda shipped to traditional markets. Now there are growing volumes of fresh cheeses such as mozzarella, cream, and cottage, which are directed to non-traditional markets in Asia. It is forecast cheese exports will recover from the dip in 2013 at 277,000MT to reach 290,000MT in 2014.

Infant milk formula (IMF) is a value added product which has enjoyed substantial export volume growth since 2009, reaching 48,000MT in 2013, up from 33,000MT in 2012. However the combination of the Whey Powder Concentrate contamination scare in August 2013, combined with new Chinese market access requirements, has dealt a severe blow to infant formula exports for 2014, which are now forecast at 35,000MT.

Note: the Marketing Year (MY) is the same as the calendar year (CY)

Milk Supply 2014



Source: Post, DairyNZ

Despite drought conditions that had threatened milk production over 43% of the total dairying area early in 2014, total milk output in New Zealand is now forecast at 21.35 million metric tons (MT) for 2014. This represents a 5.7 % increase from the reduced production levels in 2013 which had resulted from the more severe drought conditions during that period. It also represents a 3.8% upward revision from our initial forecast for 2014.

The main factor behind the more optimistic 2014 production forecast is the lack of more severe nationwide drought conditions that had existed during the same time period in 2013. The Waikato; Central Plateau; Manawatu; and Northland regions, which account for about 43% of the total New Zealand dairy herd, were very dry from late January through early April. Nevertheless, due to strong expected financial margins resulting from the high milk price forecast, farmers in these regions were able to finance purchases of feed (palm kernel extract, grain, or silage) to maintain production.

Milk production in the second half of the year is unlikely to exceed the volume produced during the same period in 2013. While expectations are that the national herd will increase by approximately 70,000 head, equating to 80 to 100 new dairy farms, it is unlikely that average milk output per head will reach the same level as in 2013 for the following reasons:

- Farmers are expected to milk their herds as far into late autumn (April-May) as possible to get the most production at the high 2013/14 season milk price. This means that cow condition at calving isn't likely to be as good as in 2013.

- It is likely that mean calving dates will be slightly delayed in 2014, which will result in cows having less time to get to peak production in October and probably not hold the peak for as long.

- In all probability it is not as likely that weather conditions and pasture growth will be as productive in 2014 as in the previous year.

PSD Milk

Dairy, Milk, Fluid (1000HD, 1000MT)	2012			2013			2014		
	Market Year Begin: Jan 2012			Market Year Begin: Jan 2013			Market Year Begin: Jan 2014		
New Zealand	Official	Old Post	New Post	Official	Old Post	New Post	Official	Old Post	New Post
Cows In Milk	5018	5018	5010	5043	5043	5103	5111	5111	5173
Cow's Milk Production	20567	20567	20567	19678	19678	20200	20569	20569	21350
Other Milk Production	0	0	0	0	0	0	0	0	0
Total Production	20567	20567	20567	19678	19678	20200	20569	20569	21350
Other Imports	1	1	1	1	1	1	1	1	1
Total Imports	1	1	1	1	1	1	1	1	1
Total Supply	20568	20568	20568	19679	19679	20201	20570	20570	21351
Other Exports	96	96	127	106	106	131	110	110	160
Total Exports	96	96	127	106	106	131	110	110	160
Fluid Use Dom. Consum.	275	275	425	300	300	450	300	300	450
Factory Use Consum.	20147	20147	19966	19223	19223	19570	20110	20110	20691
Feed Use Dom. Consum.	50	50	50	50	50	50	50	50	50
Total Dom. Consumption	20472	20472	20441	19573	19573	20070	20460	20460	21191
Total Distribution	20568	20568	20568	19679	19679	20201	20570	20570	21351
CY Imp. from U.S.	0	0	0	0	0	0	0	0	0
CY. Exp. to U.S.	0	0	0	0	0	0	0	0	0
TS=TD		0	0		0	0		0	0
(1000 Hd, 1000MT)									

Not official USDA estimates

Milk Supply 2013

By the end of 2013 milk production had reached 20.2 million MT. This was a 2.65% improvement over our October 2013 revision due to the following:

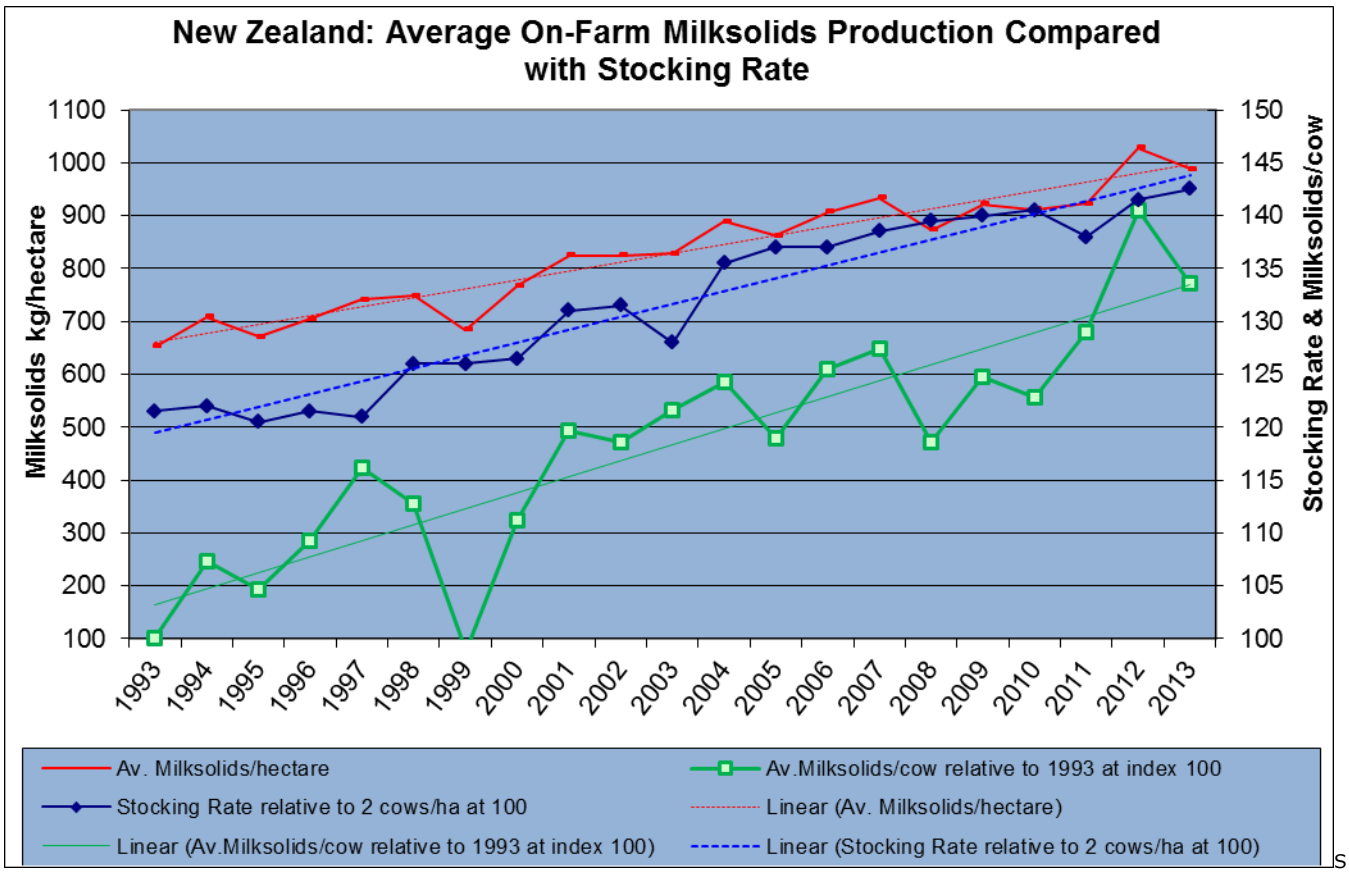
- Nationwide, cows were generally in very good condition at calving in August and September;

- Mean calving dates were earlier than normal which meant cows got to peak daily milk volumes earlier;

- Very good spring weather from late September through December led to above normal pasture quality and productivity;

- Any potential short term feed deficits at a farm level were quickly filled with purchased feed due to strong farmer financial viability based on a higher expected milk payout.

These factors combined to bring daily per head milk volumes over the whole country to record levels (Average daily per cow volumes for October were 4% to 5% above previous years).



ource: DairyNZ, Post

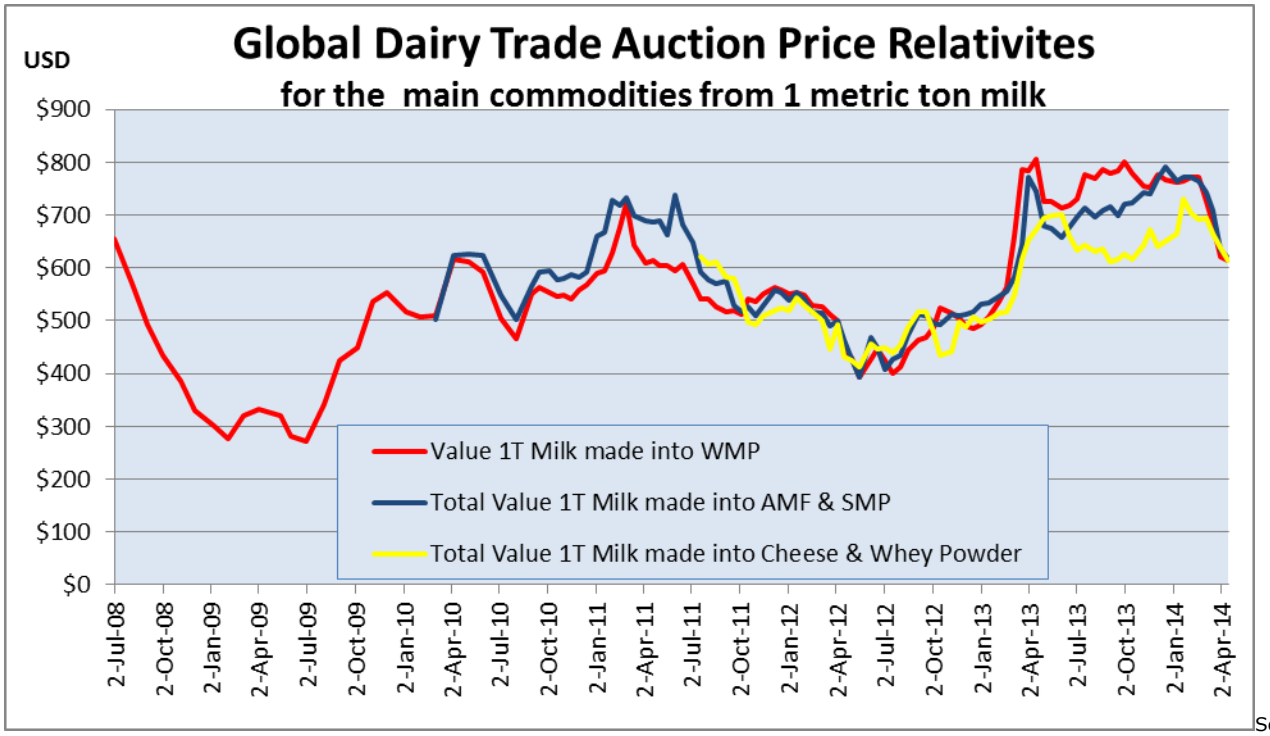
So much milk was produced at the peak that the Fonterra factories couldn't cope with it all and several million liters of buttermilk was dumped at a couple of sites in the North Island.

Domestic Consumption Liquid Milk

New data from trade sources shows the actual consumption of milk in New Zealand is actually approximately 50% greater than Post had been previously estimating. The 2012, 2013, and 2014

years have all been adjusted accordingly to 425,000MT, 450,000MT, and 450,000MT respectively.

Dairy Production and Inventories



Source: GDT, GTA, Post estimates

Whole Milk Powder (WMP)

Dairy, Dry Whole Milk Powder New Zealand	2012			2013			2014		
	Market Year Begin: Jan 2012			Market Year Begin: Jan 2013			Market Year Begin: Jan 2014		
	USDA Official	Old Post	New Post	USDA Official	Old Post	New Post	USDA Official	Old Post	New Post
Beginning Stocks	150	150	150	161	161	161	160	185	157
Production	1,273	1,273	1,273	1,275	1,275	1,300	1,300	1,300	1,367
Other Imports	1	1	1	1	1	1	1	1	1
Total Imports	1	1	1	1	1	1	1	1	1
Total Supply	1,424	1,424	1,424	1,437	1,437	1,462	1,461	1,486	1,525
Other Exports	1,261	1,261	1,261	1,275	1,250	1,291	1,350	1,334	1,339
Total Exports	1,261	1,261	1,261	1,275	1,250	1,291	1,350	1,334	1,339
Human Dom. Cons.	2	2	2	2	2	2	2	2	2
Other Use, Losses	0	0	0	0	0	12	0	0	12
Total Dom.	2	2	2	2	2	14	2	2	14

Cons.									
Total Use	1,263	1,263	1,263	1,277	1,252	1,305	1,352	1,336	1,353
Ending Stocks	161	161	161	160	185	157	109	150	172
Total Distribution	1,424	1,424	1,424	1,437	1,437	1,462	1,461	1,486	1,525
CY Imp. from U.S.	0	0	0	0	0	0	0		
CY. Exp. to U.S.	3	3	3	3	2	2	0		2
TS=TD		0	0		0	0		0	0
(1000 MT)									

Not official USDA estimates

2014

It is now forecast New Zealand (NZ) will produce 1.37million MT of WMP during 2014. This is a five percent upward revision since the initial forecast October 2013. Since 2008 WMP production has increased every year, this trend shows no sign of faltering yet. The following dynamics are working to support this:

- Chinese demand is strong and growing. Trade sources indicate that total WMP shipments to China could increase by 10-15% in the first half of 2014.

- The new 30MT per hour drier at Darfield in the South Island will be operating over the whole production season (capacity is 180,000 to 200,000 MT per annum).

- In light of the demand for export shipments during the winter shut down of the factories, which is in the order of 160,000 to 200,000 MT, it is estimated that the ending stock figure will need to be maintained near to 180,000MT and there will be extra production in 2014 to increase stocks by approximately 15,000MT during the year.

- Global Dairy Trade (GDT) Auction prices for WMP (see chart above) during October to November 2013 were way ahead of the other commodities. In terms of additional production capacity for the future Fonterra have announced they have commenced building a 15-20 MT/hour drier in the Southern North Island which will be operational for the 2015/2016 production season. In addition Open Country Dairy are said to be considering building another drier.

2013

The latest information from trade sources supports an upward revision in WMP production levels in 2013 by 2%, to 1.3million MT. These are the factors involved:

- The export tonnage in 2013 was 41,000MT higher than previously estimated;

- Domestic usage of WMP for stock feed was more accurately ascertained at 12,000MT;

- Fonterra's Drier No.2 at Darfield in the South Island began operation in earnest in September 2013. It would have added 60,000 to 80,000MT powder production by the end

of 2013; and

- WMP, because it is more cost efficient to produce, continues to be the most profitable commodity for the NZ processors (see the GDT chart above).

At peak processing capacity Fonterra, who processes about 88% of the national milk supply, can only put approximately 70% of its milk into powder stream products. When the demand really heated up for WMP during July- December 2013 and the value of milk put to WMP diverged significantly above the other commodities Fonterra reported the 30% of milk that had to be processed into other commodities was costing it NZ$0.70c/kilogram of milksolids. At the time Fonterra was forecasting a record raw milk payout to farmers of NZ$8.30/ kilogram of milksolids but a price of NZ$9.00 may have been achieved if all milk could have been processed to powder. Over the whole year approximately 85% of raw milk goes to the powder streams.

Skim Milk Powder (SMP)

Dairy, Milk, Nonfat Dry New Zealand	2012 Market Year Begin: Jan 2012			2013 Market Year Begin: Jan 2013			2014 Market Year Begin: Jan 2014		
(1000 MT)	USDA Official	Old Post	New Post	USDA Official	Old Post	New Post	USDA Official	Old Post	New Post
Beginning Stocks	54	54	54	70	70	70	49	55	85
Production	404	404	404	390	390	409	420	420	425
Other Imports	5	5	5	3	3	2	3	3	2
Total Imports	5	5	5	3	3	2	3	3	2
Total Supply	463	463	463	463	463	481	472	478	512
Other Exports	390	390	390	410	404	392	420	404	425
Total Exports	390	390	390	410	404	392	420	414	425
Human Dom. Cons.	3	3	3	4	4	4	4	4	4
Other Use, Losses	0	0	0	0	0	0	0	0	0
Total Dom. Cons.	3	3	3	4	4	4	4	4	4
Total Use	393	393	393	414	408	396	424	418	429
Ending Stocks	70	70	70	49	55	85	48	60	83
Total Distribution	463	463	463	463	463	481	472	478	512
CY Imp. from U.S.	0			0			0		
CY. Exp. to U.S.	0			0			0		
TS=TD		0	0		0	0		0	0

Not official USDA estimates

2014

Production of Skim Milk Powder (SMP) is forecast at 425,000MT in 2014 which is a one percent increase on the previous forecast. Now that the milk supply is increasing again SMP production in 2014 is likely to be four percent ahead of 2013 which would bring it back to being fairly close to historical trend increases which have been 13-14,000MT per annum. It is likely stock levels from the beginning of the year to year end will be fairly constant. Approximately 60,000 to 70,000MT of stocks are needed for shipments while the factories undergo their winter shutdown June to August. A surge of SMP is made during the peak milk flow months of October to December because a

greater throughput of milk can be achieved if SMP and butter or Anhydrous Milkfat (AMF) is made rather than WMP. It is likely stocks are built up in the spring to cover the winter shipments and to allow an orderly shipping schedule. Because SMP has very little fat content it can be kept in dry goods stores for longer periods than WMP.

2013

SMP production in 2013 is now estimated at 409,000MT which represents a five percent increase over the previous estimate. It is thought that while milk supply in 2013 was reduced in total for the year the super flush in the spring of 2013, which stretched processing capacity to the limit, meant more SMP and butter/AMF was produced during this period than previous years. As a consequence ending stocks were increased by 15,000MT to 85,000MT

Fat Products: Butter and Anhydrous Milkfat (AMF)

Dairy, Butter New Zealand	2012 Market Year Begin: Jan 2012			2013 Market Year Begin: Jan 2013			2014 Market Year Begin: Jan 2014		
(1000 MT)	USDA Official	Old Post	New Post	USDA Official	Old Post	New Post	USDA Official	Old Post	New Post
Beginning Stocks	48	48	48	45	48	48	55	48	47
Production	527	527	527	506	506	525	525	525	540
Other Imports	0	0	0	1	1	1	1	1	1
Total Imports	0	0	0	1	1	1	1	1	1
Total Supply	575	575	575	552	555	574	581	574	588
Other Exports	509	506	506	475	485	505	510	502	516
Total Exports	509	506	506	475	485	505	510	502	516
Domestic Cons.	21	21	21	22	22	22	22	22	22
Total Use	530	527	527	497	507	527	532	524	538
Ending Stocks	45	48	48	55	48	47	49	50	50
Total Distribution	575	575	575	552	555	574	581	574	588
CY Imp. from U.S.	0	0	0	0	0	0	0	0	0
CY. Exp. to U.S.	32	32	32	28	30	30	30	30	30
TS=TD		0	0		0	0		0	0

Note AMF product weight tonnages are multiplied by 1.22 to get butter equivalents; not official USDA estimates

2014

It is now forecast that production of all fat products measured in butter equivalents will be 540,000MT in 2014 which is three percent ahead of the previous forecast and three percent greater than the estimated 2013 production. After the reduced milk supply in 2013 the forecast rebound in 2014 should allow butter/AMF production to return to trend line increases of approximately 11,000MT butter equivalents per annum.

The combination of SMP and butter/AMF production is second in terms of profitability, behind WMP, for the main commodities so once demand for WMP is met then Butter/AMF and SMP production is the next in the priority line.

2013

Butter production for 2013 has been revised upward by four percent to 525,000MT mainly to account for the increase in exports during 2013. The 2013 level is now only 2,000MT below the estimate for the 2012 year. During early 2013 the sharply reduced milk supply would have

impacted on butter production but the super flush of milk in the second half of 2013 would have meant processors emphasizing butter/AMF and SMP production to deal with all the milk in time. Stock levels are estimated to be stable between 47,000MT to 50,000MT

Cheese

Dairy, Cheese New Zealand	2012 Market Year Begin: Jan 2012			2013 Market Year Begin: Jan 2013			2014 Market Year Begin: Jan 2014		
(1000 MT)	USDA Official	Old Post	New Post	USDA Official	Old Post	New Post	USDA Official	Old Post	New Post
Beginning Stocks	62	62	62	50	50	50	55	50	50
Production	321	321	328	314	319	311	320	320	324
Other Imports	5	5	5	5	5	5	5	5	5
Total Imports	5	5	5	5	5	5	5	5	5
Total Supply	388	388	395	369	374	366	380	375	379
Other Exports	306	306	306	280	290	277	300	290	290
Total Exports	306	306	306	280	290	277	300	290	290
Human Dom. Cons.	32	32	39	34	34	39	35	34	39
Other Use, Losses	0	0	0	0	0	0	0	0	0
Total Dom. Cons.	32	32	39	34	34	39	35	35	39
Total Use	338	338	345	314	324	316	335	325	329
Ending Stocks	50	50	50	55	50	50	45	50	50
Total Distribution	388	388	395	369	374	366	380	375	379
CY Imp. from U.S.	0	1	1	0	1	1	0	1	1
CY. Exp. to U.S.	13	13	13	1	1	1	1	1	1
TS=TD		0	0		0	0		0	0

Not official USDA estimates

2014

This forecast adjusts the original October 2013 forecast for cheese production upward by 4,000MT to 324,000MT to accommodate increased domestic consumption. New data on domestic consumption is showing that previously the PSD tables have been underestimating consumption by 12% to 13%.

Trend analysis suggests that production is increasing by less than 1,000MT per annum. Cheese is generally only produced when peak processing capacity is needed during the spring. Since 2000 it has been a lower margin commodity for NZ processors. That may be starting to change as NZ diversifies into fresh cheeses aimed at Asian food service and consumer ready markets.

2013

For 2013 the production estimate has been reduced by 2.5% to 311,000MT. The reduced milk supply in the first half of 2013 is one factor combined with the reduced level of exports in 2013 has meant not as much cheese was needed. Even though the super flush of milk during September to December would have necessitated cheese manufacture it is estimated the reduction earlier in the year was not compensated for by the boost in production in the second half of 2013.

Other New Processing Capacity

Infant Milk Formula (IMF) Production

Two Chinese Companies are in the process of building factories dedicated to manufacturing infant milk formula products. Mengnui/Yashilli is building a plant just south of Auckland which will be capable of producing 50,000MT per annum. This plant will be able to take raw milk or ingredients such as SMP to make IMF. The management is already in talks with both Fonterra and Open Country Dairies regarding sourcing milk. Villi is building a factory in South Canterbury, South Island and will be sourcing milk directly from farmer suppliers. Both companies are likely to be eligible to receive up 50 million liters of raw milk from Fonterra under the Dairy Industry Restructuring Act raw milk regulations.

Westland Dairy Cooperative is also building a nutritional drier at its base in Hokitika, South Island. It is aiming at producing high end nutritional products, such as IMF, primarily being aimed at markets in Australia, S.E.Asia, and China.

Ultra-Heat Treated (UHT) Milk

Fonterra opened a new UHT processing facility in April 2014. Reportedly it is being focused initially at cream production. When all five of its processing lines are operational it will use approximately 100,000 MT of milk per year.

Tatua Cooperative Dairy Company

Tatua has started on its largest building program yet with an investment on a specialized powder drier, which will dry hydrolyzed protein. This pre-digested soluble protein can be used in a variety of nutritional products including IMF.

Dairy Exports

Whole Milk Powder

New Zealand Export Statistics for Whole Milk Powder									
for Calendar Years: 2011 - 2013									
Partner Country	2011			2012			2013		
	Value millions USD	Quantity (metric tons)	FOB Price USD/T	Value millions USD	Quantity (metric tons)	FOB Price USD/T	Value millions USD	Quantity (metric tons)	FOB Price USD/T
China	1,096.96	302,261	3,629	1,371.08	423,435	3,238	2,759.17	622,133	4,435
UAE	261.05	67,700	3,856	316.30	91,893	3,442	311.69	76,635	4,067
Venezuela	361.59	90,078	4,014	349.12	92,807	3,762	307.59	67,312	4,570
Sri Lanka	241.72	64,398	3,754	195.74	56,927	3,438	171.78	45,339	3,789
Malaysia	146.13	38,218	3,824	144.58	41,703	3,467	148.43	36,829	4,030
Thailand	110.19	30,760	3,582	95.75	30,132	3,178	135.98	31,609	4,302
Singapore	123.59	36,634	3,374	88.35	30,635	2,884	129.47	35,123	3,686
Algeria	309.31	79,602	3,886	250.33	75,426	3,319	127.14	32,752	3,882
Nigeria	70.72	18,442	3,835	105.65	30,777	3,433	115.39	27,123	4,254
Taiwan	100.84	26,558	3,797	83.63	26,116	3,202	112.30	26,294	4,271
Rest of World	1,372.39	354,981	3,866	1,292.24	361,423	3,575	1,221.56	290,309	4,208
World Total	**4,194.49**	**1,109,635**	**3,780**	**4,292.78**	**1,261,278**	**3,404**	**5,540.51**	**1,291,460**	**4,290**

Source: GTA

For 2014 it is now forecast that exports will reach 1.34 million MT, which would be just 5,000 MT ahead of the previous forecast and four percent greater than 2013's revised actual total of 1.29 million MT. This magnitude of annual increase forecast is in line with the recent trend. Commentators in New Zealand are saying demand in China is expected to increase again in 2014 which backs up forecasts for increased exports.

Demand increases for WMP out of China haven't stopped to draw breath for nearly five years now. The tonnage shipped from NZ in 2013 was up 47% over 2012. In NZ the reason for the jump in 2013 was put down to an estimated reduction in China's domestic milk supply of 5% to 6%.

Chinese buyers' ability to pay the escalating prices needed to secure product crowded other buyers out of the market. The GDT auction price chart above shows the steep rise in prices over 2013.

In 2000 New Zealand's contribution to world trade in WMP was approximately 24%, in 2013 it had reached just over 50%. The key reasons New Zealand has been able to grow its exports so quickly and stays competitive are:

- Dairying has been the most profitable large scale land use on flat and easy country in New Zealand for over 20 years which has allowed rapid expansion of the sector and;
- New Zealand cows have high protein and fat levels in their milk relative to most other major milk producing regions which makes it easier to manufacture to specifications;
- New Zealand is at the forefront with drying technology and has international scale processing facilities;
- There are very good channels to market, many pioneered in the 1980's and 1990's by the former NZ Dairy Board which had statutory powers to exclusively export New Zealand dairy products until 2001 when the sector was de-regulated and;
- China has emerged since 2008 has the pre-eminent destination for WMP and has been willing to purchase all the increases in production NZ has been able to provide.

New Zealand milk supply is expected to continue increase sustainably at around 2% per annum which could mean WMP exports could go on increasing at a rate of 40-60,000 MT per annum indefinitely.

Skim Milk Powder (SMP)

New Zealand Export Statistics for Skim Milk Powder									
For Calendar Years: 2011 - 2013									
Destination Country	2011			2012			2013		
	Value USD mil.	Qty (MT)	Av. FOB Price/ MT	Value USD mil.	Qty (MT)	Av. FOB Price/ MT	Value USD mil.	Qty (MT)	Av. FOB Price/ MT
China	265.40	77,474	$3,426	325.13	100,851	$3,224	563.42	132,527	$4,251
Malaysia	122.52	33,871	$3,617	120.09	34,593	$3,472	151.45	36,106	$4,195
Philippines	118.69	33,712	$3,521	99.24	30,738	$3,229	146.08	34,958	$4,179
Indonesia	84.66	23,524	$3,599	118.97	37,413	$3,180	137.92	33,780	$4,083
Singapore	61.49	18,678	$3,292	67.40	21,269	$3,169	92.41	23,575	$3,920
Thailand	99.94	29,899	$3,343	67.52	22,545	$2,995	64.62	15,816	$4,086
Taiwan	43.00	11,962	$3,595	39.13	12,055	$3,246	62.56	14,841	$4,216
Saudi Arabia	95.67	26,781	$3,572	75.84	23,761	$3,192	42.48	10,112	$4,201
Vietnam	20.57	5,876	$3,500	42.27	13,648	$3,097	39.39	10,496	$3,753
Japan	17.71	5,021	$3,527	21.04	5,929	$3,549	28.70	7,251	$3,958
Rest of world	339.77	94,826	$3,583	287.18	86,826	$3,308	297.28	72,506	$4,100
World	**1,269.43**	**361,625**	**$3,510**	**1,263.82**	**389,624**	**$3,244**	**1,626.31**	**391,969**	**$4,149**

Source: GTA

The SMP export forecast in 2014 is calling for a five percent upward revision of the shipments to 425,000MT. While the actual level of SMP exports in 2013, at 392,000MT were three percent lower than previously estimated it is expected there will be a return to trend-line volumes. SMP is an ingredient for many value added products(ice-cream, yoghurts, vegetable fat filled powders, milk protein concentrates, and IMF) so if it becomes more profitable to manufacture those products in New Zealand then volume will be diverted away from direct exports to further manufacture. It isn't seen as a significant probability this year but could divert the last 5,000 to 10,000 MT away from the total.

Cheese

Cheese exports in 2014 are expected to be 290,000 MT which is no change from the previous forecast. In 2013 exports were 277,000 MT which was 13,000 MT (4.5%) below the previous forecast. In early 2013 the nationwide drought reduced milk supply which meant only the most profitable dairy products were produced. It is likely cheese production and subsequent exports were reduced in order to maintain WMP exports.

New Zealand Export Statistics for Cheese

for Calendar Years: 2011 - 2013

Destination Country	2011			2012			2013		
	Value USD mil.	Quantity (MT)	Av FOB price/ T	Value USD mil.	Quantity (MT)	Av FOB price/ T	Value USD mil.	Quantity (MT)	Av FOB price/ T
Japan	255.72	61,175	$4,180	250.87	64,754	$3,874	263.09	64,296	$4,092
Australia	206.54	46,471	$4,445	183.36	45,619	$4,019	166.47	37,661	$4,420
China	57.48	13,536	$4,247	76.48	17,852	$4,284	96.86	21,367	$4,533
Korea South	90.01	20,085	$4,482	100.75	25,457	$3,958	92.55	21,728	$4,259
Philippines	42.71	10,186	$4,193	45.79	12,545	$3,650	46.15	11,729	$3,935
Saudi Arabia	29.11	6,940	$4,194	66.29	18,862	$3,515	46.08	11,775	$3,914
Indonesia	38.82	8,800	$4,411	49.36	13,352	$3,697	44.55	11,036	$4,037
Chile	5.02	1,281	$3,917	17.65	5,054	$3,492	40.75	10,502	$3,880
Taiwan	29.62	6,865	$4,314	22.69	5,936	$3,822	29.71	7,464	$3,980
Egypt	22.35	5,990	$3,732	35.96	10,361	$3,471	29.00	7,527	$3,852
Rest of	302.60	71,533	$4,23	328.93	85,854	$3,83	301.83	71,800	$4,20

World			0			1			4
World Total	**1079.98**	**252,858**	**$4,271**	**1178.12**	**305,647**	**$3,855**	**1157.04**	**276,886**	**$4,179**

Source: GTA

The nature of New Zealand's cheese production is changing and so are the target markets. From 1992 to 2013 the linear trend for the volume of cheese exports showed an annual increase of 6,500 MT to 7,000 MT. However if the trend is examined from 2000 it is showing only a 750-800 MT per annum increase. It could be said that cheese exports are essentially stable now. However that belies what is going on under the surface. Fresh cheese exports are on a growth trend. They include cottage, cream, and mozzarella cheeses as well as curd. Since 2005 this category has increased from 36,461MT up to 51,683MT. Ninety seven percent of this production is going to Asia and Australia compared with 57% for all cheese exports. The products are going direct to consumers and to food service businesses.

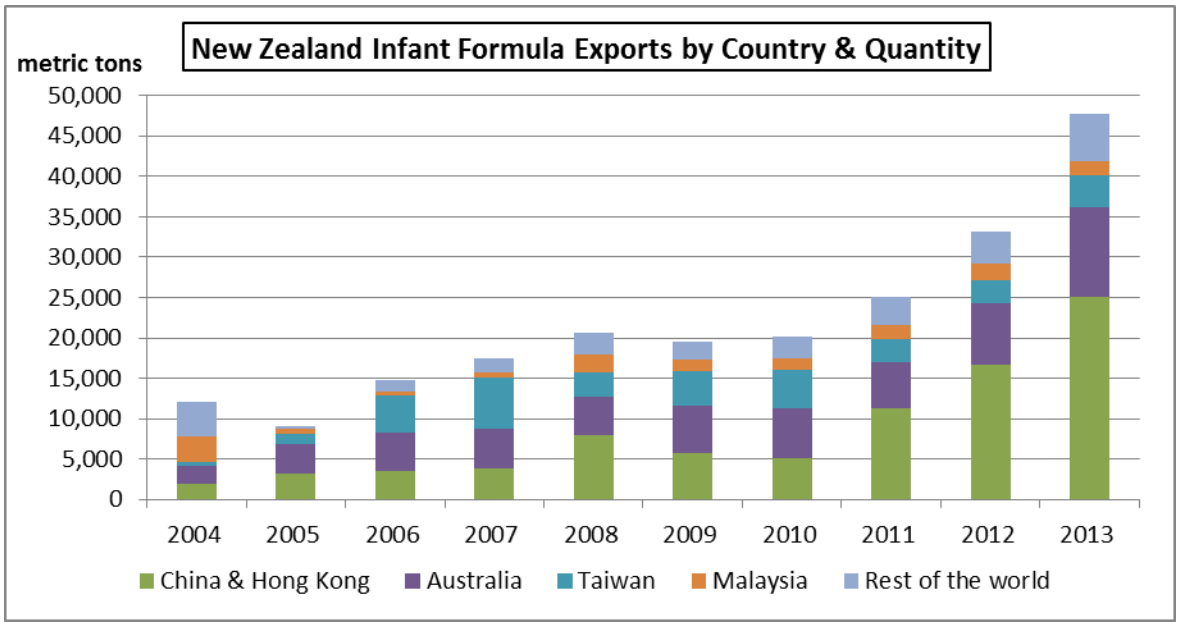
Fonterra's new Individual Quick Frozen (IQF) grated Mozzarella which can be made in 24 hours is an example of this new type of product. By September 2015 Fonterra will have capacity to produce 50,000 MT per annum of IQF grated Mozzarella.

Exports of the natural ingredient cheeses such as Cheddar and Gouda have averaged 193,000MT per annum since 2005 but with a slight downward trend of approximately 2,500MT per annum. Processed cheese exports appear to be on a significant downward trend since 2005, having decreased by 23% from 27,500 MT in that year.

Butter and Anhydrous Milkfat (AMF) Exports

Exports of fat products in butter equivalents for 2014 are forecast to reach 516,000 MT in line with forecast production increases. This revision equates to a three percent increase. In 2013 actual exports exceeded previous expectations by 20,000MT (4%) to reach 505,000MT only 1,000MT less than 2012. WMP and the Butter/SMP combination were the commodities with significantly better profitability during 2013 so were going to be produced at the expense of the other commodities.

Infant Milk Formula (IMF)

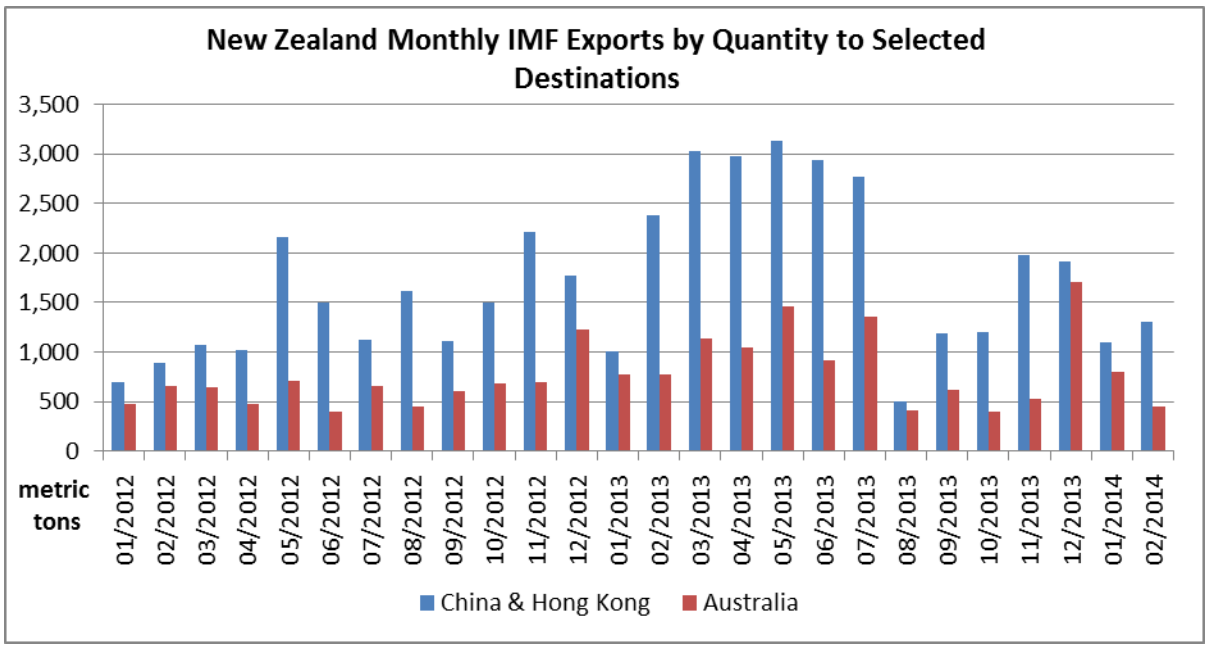


Source: GTA

New Zealand IMF exports surged ahead during 2012 and going into 2013. The bulk of the increase has been going to China, Hong Kong, and Australia. However this all came to an abrupt end at the beginning of August 2013 when Fonterra reported a batch of Whey Protein Concentration (an ingredient to IMF) was contaminated with clostridium bacteria.

At the time it was mistakenly thought to be the botulism causing bacteria. This news took hold in the media which scared consumers away from NZ product. Even though it was confirmed it wasn't clostridium botulinum, by September 2013, exports have still not recovered to pre August 2013 levels. While the media reports have concentrated on what has happened in China, exports to Australia have also been reduced significantly.

It is now forecast that IMF shipments in 2014 will be back to 2012 levels at around 35,000 MT at best. Market access issues in China are now the main pre-occupation for exporters and MPI.



Source: GTA

Imports

Lactose

Imports of lactose in 2013 were 74,637MT just down from 76,477MT in 2012. However it appears there may be some imports of lactose are coming in coded to whey products on customs documents. This probably means lactose imports are actually still increasing. Lactose is used by dairy processors to standardize production of WMP. Every ton of lactose is re-exported as a ton of WMP. This has been good business for the processors who earned a margin of around NZ$3,000/MT in 2013 on all imports

In 2013 81% of the imports were sourced from the US well up from the 68% proportion in 2012.

Trade Policy - Market Access Issues

WPC80 Contamination Ongoing Access Difficulties China & Sri Lanka

As a result of the WPC80 contamination issue, (described above in IMF exports section and in detail in NZ Gain Report NZ1314 September 2013) Chinese authorities are still blocking imports of whey and base powders (IMF ingredients) from Fonterra. This is not particularly significant as whey powder exports to China made up 1.5% of the total volume shipped in 2012, and 3% by value.

There has been ongoing fallout in New Zealand in the wake of the August 2013 incident: Fonterra conducted two internal reviews culminating in a wide ranging board of directors' inquiry which used external experts to perform it. MPI carried out an investigation which ended with Fonterra being charged in the High Court. Fonterra pleaded guilty and was fined $300,000. In addition the Government has carried out a separate review. It has been reported Chinese officials were waiting for the results of the Government inquiry before allowing trade to re-commence. It is unclear what is now holding up the re-start for whey and base powder exports from Fonterra.

In Sri Lanka 130 MT of powder was destroyed after it was held in storage beyond the food safety use-by date. There was a dispute over testing results which Sri Lankan officials said showed traces of Dicyandiamide (DCD) was present in the powder.

New IMF Access Regulations China

While in New Zealand it may seem the crackdown on the plethora of brands of IMF being imported into China is linked to the WPC80 incident that may have only hastened the resolve by Chinese officials to get control of food safety in China and in particular infant nutrition. It has more to do with the melamine scandal dating from 2008 and the many food safety problems emanating from within China. Chinese officials are working on a plan to whittle down the several hundred brands of IMF on the market, which there is virtually no control over from a food safety view, to six domestic champions who will manufacture and market their own brands. The same logic is being applied to NZ IMF exporters where there are at least 50 exporters with perhaps over 100 brands. In order to qualify to export IMF to China an exporter will have to demonstrate a close association with the manufacturer.

Even though the regulations in China came into force May 1, 2014 it is still unclear what a "close association" actually means. At the time of writing five of the total of thirteen manufacturers present in NZ have been certified and listed by the Chinese authorities. Fonterra and Westland Cooperatives are among the five who are actually responsible for approximately 90% of the present tonnage produced in NZ. Synlait another significant dairy processor is still waiting to be certified. Originally the May 1 deadline for companies to be officially listed or have imports blocked did not include product already on the water however that provision now seems to have been removed which is causing consternation among exporters in New Zealand who are not on the official list.

The listing process and subsequent fall-out will disrupt trade to some extent although Synlait for example said it had built up stocks in China to be able continue its sales program even though shipments may be interrupted for a period of months.

Ramifications for Cheese Exports to Japan in the Wake of the Australia/Japan Trade Agreement

Virtually all natural cheese imported into Japan has the added burden of a 29.8% tariff unless processors can show they are using one ton of domestic cheese for every 2.5 tons of imported cheese (the mixing ratio). In which case the imported cheese enters tariff free. Australia has achieved a slightly better deal under its trade agreement with a new mixing ratio of 1T domestic to 3.5T imports on initially 4,000MT of imports increasing to 20,000 MT over 20 years. New Zealand's cheese shipments to Japan have been travelling nicely upwards over the last five years increasing from just over 50,000Mt to over 64,000 MT in 2013. It is thought, initially that the Australian advantage won't have much effect on NZ exports. Although, over time, if there is no TPP agreement which would bring NZ up to parity there will be slippage in New Zealand's competitiveness in this market.